Economic Outlook

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

July 1985

The economy has been in the doldrums but is now poised for a reacceleration in growth. Interest rates are generally at their lowest levels in years, while inventories have come under better control during the past several quarters. Although further enlargement of the merchandise trade deficit will continue to be a drag on growth, the prospects remain favorable that this recovery will prove to be of considerably longer duration than average. Real GNP is now expected to rise 2.7% from the fourth quarter of 1984 to the fourth quarter of 1985, followed by a similar increase next year.

Real GNP rose at a modest 1.7% annual rate in the second quarter, less than the 3.1% increase indicated by the "flash" forecast. Although this growth is an improvement from the paltry 0.3% increase in the first quarter, taken together the pattern indicates sluggish performance. Nevertheless, the situation is better than it may seem. Much of the weakness in the second quarter was the result of a dramatic slowing in inventory accumulation. Real final sales--that is, real GNP excluding the change in inventories--grew at a respectable 5.1% rate, following a decline of 0.3% in the first quarter. The improvement was broad-based. Net exports still detracted from growth, but to a lesser extent than in the first quarter. Net exports have been extremely volatile on a quarterly basis and have been largely responsible for the erratic pattern of growth in real final sales in this recovery. Real GNP is likely to be increasing at a rate somewhat higher than 4% during the second half of this year.

The cautious approach to inventory management has been evident across all major sectors of business. As an example, the combined effects of aggressive inventory building and a slowdown in sales produced an uncomfortable 21.0% rise in inventories of department stores from December 1983 to December 1984. As of this May, however, their inventories were just 4.3% higher than a year ago. Unfortunately, because of lackluster sales the inventory/sales ratio is still at the same level as a year ago. As a result, retailers will likely continue to maintain tight control over inventories in coming months.

As retailers first began to restore control over their inventories, their vendors felt sharp cutbacks in orders. Manufacturers are in an improved position now that the retail situation has stabilized. For example, manufacturers of home goods and apparel had a substantial 3.8% rise in new orders in May from the April level after several declines earlier in the year. In addition, their inventories fell by a significant 1.6% in May from the April level and are now 2.7% below year-end 1984. These developments--rising orders and declining inventories--bode well for improved growth in coming months.

The trade deficit remains an obstacle to an overall rebound in growth. The trade deficit averaged $147.1 billion at an annual rate in April and May, compared to a deficit of $123.3 billion in 1984 and $131.1 billion in the first quarter. The recent substantial depreciation of the dollar is helpful for U.S. manufacturers, but the dollar is still about 67% higher against the mark, for example, than the low in 1980. The still strong dollar remains a major impediment to a sustained revival in the U.S. industrial sector.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual		1985		Forecast 1986				Actual 1983-1984	Forecast 1984-1985	Forecast 1985-1986
	I	II	III	IV	I	II	III	IV			
Gross National Product	5.6	4.6	7.9	8.7	8.9	8.2	6.4	7.5	10.8	6.5	7.9
Real GNP	0.3	1.7	4.3	4.6	4.0	3.8	1.5	2.3	6.8	2.6	3.5
GNP Price Deflator	5.4	2.8	3.5	3.9	4.7	4.2	4.8	5.1	3.8	3.8	4.2

	Actual 1985: II	Forecast 1985:III	Actual 1983-1984	Forecast 1984-1985	Forecast 1985-1986
Consumer Spending	8.4%	8.2%	8.6%	7.6%	8.2%
Durable Goods	7.2	3.5	13.9	7.4	7.1
Nondurable Goods	8.2	7.2	6.9	5.2	7.3
Services	8.8	10.2	8.5	9.4	9.0
Business Capital Spending	14.6	12.9	20.6	11.3	10.3
Structures	22.8	19.5	16.0	16.2	11.6
Equipment	10.1	9.2	23.4	8.7	9.5
Residential Investment	11.8	9.7	16.4	3.9	2.3
			1984	1985	1986
Change in Inventories	$12.6b.	$20.0b.	$58.2b.	$25.3b.	$37.5b.
Net Exports of Goods and Services	$-91.1b.	$-109.0b.	$-64.2b.	$-95.0b.	$-117.0b.
			1983-1984	1984-1985	1985-1986
Government Purchases	9.4%	8.6%	9.0%	9.3%	7.3%
Federal	6.8	8.6	9.5	11.2	6.0
Defense	12.5	8.6	10.5	9.5	6.6
Other	-7.2	9.0	6.7	16.2	4.3
State & Local	11.1	8.6	8.7	8.1	8.2
Corporate Profits Before Tax	-7.7*F	5.0*	16.0	-1.2	7.1
Corporate Profits After Tax	-6.9*F	2.7*	14.5	-1.6	7.1
Plant and Equipment Expenditures	4.4	16.1	16.0	9.2	7.3
Real Final Sales#	5.1	3.5	5.0	3.5	3.3
Real Disposable Personal Income	9.3	3.7	6.7	3.6	3.4

Economic Indicators	Recent Data Apr.	May	June	Actual 1983-1984	Forecast 1984-1985	1985-1986
Consumer Price Index**	4.8%	2.4%	n.a.	4.3%	4.2%	4.6%
Producer Price Index for Finished Goods**	3.6	2.4	0.0	2.1	2.8	4.0
Industrial Production	2.4	1.2	1.2	11.5	2.8	3.7
Retail Sales##	3.1	-0.5	-0.8	10.5	6.1	7.2
				1984	1985	1986
Auto Sales (millions of units, a.r.)	11.1	11.3	10.3	10.4	10.8	10.2
Housing Starts (millions of units, a.r.)	1.93	1.67	1.71	1.75	1.76	1.68
Unemployment Rate	7.3%	7.3%	7.3%	7.5%	7.2%	6.8%
Merchandise Trade Deficit (a.r.)	$142.2b.	$152.0b.	n.a.	$123.3b.	$150.0b.	$170.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast

July 19, 1985